DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 05-0046
Individual Adjusted Gross Income Tax
For 1999 and 2000

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Imposition of the State's Individual Income Tax by Reference to Taxpayers' Federal Adjusted Gross Income.

Authority: Ind. Const. art. I, § 25; Ind. Const. art. IV, § 1; Ind. Const. art. X, § 8; IC 6-3-1-3.5; Ind. Dept. of Envtl. Management v. Chemical Waste Management, Inc., 643 N.E.2d 331 (Ind. 1994); Campbell v. Heiss, 53 N.E.2d 634 (Ind. 1944); Bissell Carpet Sweeper Co. v. Shane Co., 143 N.E.2d 415 (Ind. 1957).

Taxpayers argue that imposition of the Indiana income tax by reference to the federal income tax law is a violation of the Indiana constitution.

II. Sufficiency of Taxpayers' Indiana Tax Return.

Authority: IC 6-3-1-3.5; United States v. Kimball, 896 F.2d 1218 (9th Cir. 1990); United States v. Long, 618 F.2d 74 (9th Cir. 1980); Cooper Industries, Inc. v. Indiana Dept. of State Revenue, 673 N.E.2d 1209 (Ind. Tax Ct. 1996); 45 IAC 3.1-1-1.

Taxpayers maintain that their Indiana tax returns were not "frivolous."

III. Definition of "Income" for Purposes of Imposing the State's Individual Income Tax.

Authority: U.S. Const. amend. XVI; Ind. Const. art X, § 8; IC 6-3-1-3.5 et seq.; IC 6-3-1-9; IC 6-3-1-12; IC 6-3-1-15; I.R.C. § 61; New York v. Graves, 300 U.S. 308 (1937); Burnet v. Harmel, 287 U.S. 103 (1932); Bowers v. Kerbaugh-Empire Co., 271 U.S. 170 (1926); Merchants' Loan Trust Company v. Smietanka, 255 U.S. 509 (1921); Eisner v. Macomber, 252 U.S. 189 (1920); United States v. Connor, 898 F.2d 942 (3rd Cir. 1990); Wilcox v. Commissioner of Internal Revenue, 848 F.2d 1007 (9th Cir. 1988); Coleman v. Commissioner of Internal Revenue, 791 F.2d 68 (7th Cir. 1986); United States v. Koliboski, 732 F.2d 1328 (7th Cir. 1984); United States v. Romero, 640 F.2d 1014 (9th Cir. 1981); Snyder v. Indiana Dept. of State Revenue, 723 N.E.2d 487 (Ind. Tax Ct. 2000); Thomas v. Indiana Dept. of State

Revenue, 675 N.E.2d 362 (Ind. Tax. Ct. 1997); Richey v. Indiana Dept. of State Revenue, 634 N.E.2d 1375 (Ind. Tax Ct. 1994)

Taxpayers claim that any money they received during 1999 and 2000 was not subject to the state's adjusted gross income tax. Taxpayers argue that only corporate income is subject to income tax.

STATEMENT OF FACTS

Taxpayers are Indiana residents who filed state income tax returns for 1999 and 2000. The Department of Revenue (Department) adjusted the taxpayers' returns based on income information contained on the taxpayers' W-2 forms. As a result, the Department sent taxpayers notices of "Proposed Assessment."

Taxpayers disagreed with the Department's conclusion and assessments. Taxpayers submitted a protest letter to that effect. The protest letter challenged the Department's conclusions. The taxpayers also challenged adjustments made for 1996, 1997, 1998, and 2001; however, the taxpayers' challenges of those latter adjustments had been addressed in three Letters of Finding previously issued by the Department.

Upon assignment to the Hearing Officer, taxpayers were notified of their opportunity to take part in an administrative hearing and to further explain the basis for their protest. Taxpayers chose not to respond. Taxpayers were notified a second time and provided a second opportunity to schedule the hearing. Taxpayers again chose not to respond despite their own initial written "demand" for just such a hearing. Consequently, this Letter of Findings was written based entirely upon taxpayers' original protest letter.

DISCUSSION

I. Imposition of the State's Individual Income Tax by Reference to Taxpayers' Federal Adjusted Gross Income.

Taxpayers argue that the proposed assessments represent a "blatant violation of the Indiana Constitution . . . ." because "[n]owhere in the Indiana Constitution did the people of this State give any power or authority to the federal government to make laws exclusively for those living in Indiana." According to taxpayers, the Department's attempt to hold them accountable to a state law based upon a federal statute (whose specific provisions had never been incorporated into the laws of Indiana) "obviously represents an illegal and unconstitutional delegation of legislative authority by the Indiana legislature to the U.S. Congress which is specially barred by the Indiana Constitution."

Taxpayers states that if the Department attempts to enforce against them a federal law, they will seek punitive damages from the Department and will take the matter up with the Indiana Supreme Court.

In effect, taxpayers argue that the Indiana Constitution does not permit references to another taxing jurisdiction's own laws; because taxpayers are now faced with just such an improper reference to federal law – such as that found within IC 6-3-1-3.5 – the taxpayers' compliance with the state tax law is not required.

Because taxpayers did not take part in an administrative hearing and because taxpayers did not provide a more detailed explanation of their state constitutional argument, the Department must assume that taxpayers' based their argument on Ind. Const. art. I, § 25 which states that, "No law shall be passed, the taking effect of which shall be made to depend upon any authority, except as provided in this Constitution." This section of the state constitution is intended to place a limit on "the legislative activity of the General Assembly." Ind. Dept. of Envtl. Management v. Chemical Waste Management, Inc., 643 N.E.2d 331, 341 (Ind. 1994).

The Indiana Constitution vests legislative authority in the Indiana General Assembly. "The Legislative authority of the State shall be vested in a General Assembly, which shall consist of a Senate and a House of Representatives. The style of every law shall be: 'Be it enacted by the General Assembly of the State of Indiana': and no law shall be enacted, except by bill." Ind. Const. art. IV, § 1. Taxpayers are correct in their assertion that, under Ind. Const. art. I, § 25 and Ind. Const. art. IV, § 1, the Indiana General Assembly may not delegate either its authority or its exclusive responsibility for performing legislative functions. "The power to legislate or to exercise a legislative function cannot be delegated to a non-governmental agency or person. Nor can the Legislature delegate its law-making power to a governmental officer, board, bureau or commission." Bissell Carpet Sweeper Co. v. Shane Co., 143 N.E.2d 415, 419 (Ind. 1957) (Internal citations omitted).

On its face, taxpayers' contention appears to have merit. The Indiana General Assembly may not delegate to the federal government the Assembly's own responsibility for defining or enforcing the state's adjusted gross income tax scheme. Neither may the Assembly's authority to implement such a scheme be obtained under federal law. However, the cross-references to the Internal Revenue Code – such as I.R.C. § 62 cited within IC 6-3-1-3.5 – do not delegate the Assembly's taxing authority to the federal government. The Assembly did not turn over its taxing authority to the federal government. The Assembly did not obtain its taxing authority from the federal government. Ind. Const. art. X, § 8 unambiguously states that, "The general assembly may levy and collect a tax upon income from whatever source derived, at such rates, *in such manner*, and with such exemptions as may be prescribed by law." (*Emphasis added*). The Indiana Code provisions containing references to the I.R.C. reflect merely the legislature's independent decision to employ the federal tax calculation as the starting point for determining Indiana's adjusted gross income tax. "It is well settled that a legislative body may enact a law, the operation of which depends upon the existence of a stipulated condition." Campbell v. Heiss, 53 N.E.2d 634, 636 (Ind. 1944). The state legislature has retained its independent authority to define and enforce the state's own income tax plan. That the Indiana General Assembly has retained exclusive authority to stake out the parameters of the state's adjusted gross income tax scheme, is evidenced by the Assembly's regular decisions to periodically reenact IC 6-3-1-3.5 the latest of which occurred in 2004. Whether the General Assembly should have avoided references to the Internal Revenue Code, drafted original statutory provisions mirroring the Internal Revenue Code, and then require every Indiana taxpayer to recalculate his or her taxable

income, is an issue beyond the scope of this Letter of Findings and is irrelevant to determining taxpayer's existing tax liability. It is enough to say that the General Assembly acted entirely within its authority in employing the federal adjusted gross income as the jumping off point for calculating the individual taxpayer's Indiana adjusted gross income. It is no different than if the General Assembly simply adopted federal guidelines for state road construction or if the General Assembly adopted Illinois procedures for removing underground fuel tanks. The federal government did not decide that Indiana residents should pay a state income tax; the General Assembly did.

FINDING

Taxpayers' protest is denied.

II. Sufficiency of Taxpayers' Indiana Tax Return.

Taxpayers have set out various arguments in support of their belief that they were not liable for Indiana income tax for income received during 1999 and 2000. One of their arguments is based upon the undisputed fact that they reported "0" income on their corresponding federal returns. According to taxpayers, they were thereafter – under penalty of law – obliged to report the identical amount ("0") on their state return. In support of their argument taxpayers have reported a copy of their 2000 federal return and, indeed, it is apparent that taxpayers reported "0" on their federal return.

It is also not disputed that the Indiana tax return for the tax year 2000 employs federal adjusted gross income as the starting point for determining a taxpayer's state individual income tax liability. Line one of the IT-40 state form requires the taxpayer to "Enter your Federal adjusted gross income from your Federal return (see page 9)."

IC 6-3-1-3.5 states as follows: "When used in IC 6-3, the term 'adjusted gross income' shall mean the following: (a) In the case of all individuals 'adjusted gross income' (as defined in Section 62 of the Internal Revenue Code) . . . ." Thereafter, the statute specifies addbacks and deductions, peculiar to Indiana, which modify the federal adjusted gross income amount. The Department's regulation concisely restates the same formulary principal. 45 IAC 3.1-1-1 defines individual adjusted gross income as follows:

> Adjusted Gross Income for Individuals Defined. For individuals, "Adjusted Gross Income" is "Adjusted Gross Income as defined in Internal Revenue Code § 62 modified as follows:
>
> > (1) Begin with gross income as defined in section 61 of the Internal Revenue Code.
> > (2) Subtract any deductions allowed by section 62 of the Internal Revenue Code.
> > (3) Make all modifications required by IC 6-3-1-3.5(a).

Both the statute, IC 6-3-1-3.5, and the accompanying regulation, 45 IAC 3.1-1-1, require that an Indiana taxpayer employ the federal adjusted gross income calculation, as determined under I.R.C. § 62, as the starting point for determining the taxpayer's Indiana adjusted gross income.

Taxpayers' contention – that they were compelled by force of law to declare "0" as Indiana adjusted gross income because they declared "0" on his federal return – is meritless. The Indiana statute is unambiguous. Indiana adjusted gross income begins with federal taxable income as defined by I.R.C. § 62, not as reported by the taxpayer. *See* Cooper Industries, Inc. v. Indiana Dept. of State Revenue, 673 N.E.2d 1209, 1213 (Ind. Tax Ct. 1996). The directions contained within the Indiana income tax form provide the individual taxpayer with abbreviated directions for completing the form. The Indiana tax form simply instructs a taxpayer to put which number inside of which box. Those directions notwithstanding, a taxpayer is nonetheless required to actually perform the calculations necessary to determine his Indiana adjusted gross income tax liability.

Taxpayers have cited to various cases in support of the proposition that they are in full compliance with the tax laws simply by placing a "0" on their tax return. Taxpayers cite to United States v. Long, 618 F.2d 74 (9th Cir. 1980) and United States V. Kimball, 896 F.2d 1218 (9th Cir. 1990). However, neither case supports the fanciful notion that a taxpayer has fulfilled his obligations by merely placing a "0" on the form. Rather, in the cited cases, the defendants were being criminally prosecuted for *failing to file* an income tax return. *See* 26 U.S.C.S. § 7203. In the Long case, the court found that "A return containing false of misleading figures is still a return." Long, 618 F.2d at 76. The cases cited by the taxpayers are entirely irrelevant to taxpayers' underlying argument that they do not have to pay income tax. Taxpayers are not being criminally prosecuted for failure to file a return because it is clear that taxpayers *did* file an Indiana tax return for 1999 and 2000. Rather, the issue is whether the taxpayers owe adjusted gross income tax because the numbers written on the returns were the wrong numbers.

Taxpayers reported receiving zero income for 1999 and 2000. Fanciful semantics aside, they reported their income incorrectly, and they now owe income tax for those years.

FINDING

Taxpayers' protest is denied.

III. Definition of "Income" for Purposes of Imposing the State's Individual Income Tax.

Taxpayers argue that "wages" for services do not constitute taxable income. Taxpayers believe that only corporate profits are subject to federal or state income tax. Since taxpayer's did not obtain "corporate profits" during 1999 and 2000, they maintain that they do not owe state income tax.

Taxpayers' argument is that – for purposes of determining income tax liability – "income" can only be derivative of corporate activity. Therefore, as individual Indiana residents who by definition did not receive "corporate" income, taxpayers are not subject to the adjusted gross income tax because the ordinary income received by individuals is not "taxable income."

Taxpayers have offered a number of Supreme Court cases which purportedly support taxpayers' basic contention. Taxpayers cites to Merchants' Loan Trust Company v. Smietanka, 255 U.S. 509 (1921) for the proposition that income tax can only be levied against corporate gains. In that case, the Court held that the when a provision in a will created a trust, the increase of the value of the trust resulted in taxable "income" under the provisions of the U.S. Const. amend. XVI. Id. In arriving at that decision, the Court stated that "the word [income] must be given the same meaning and content in the Income Tax Acts of Congress that was given to it in the Corporation Excise Tax Act and that what that meaning is has now become definitely settled by decisions of [the] court." Id. 519.

Taxpayers also cite to Eisner v. Macomber, 252 U.S. 189 (1920), a case in which the Court addressed the issue of whether the U.S. Const. amend. XVI permitted the government to tax a taxpayer's stock dividends resulting from a corporation's accumulated profits. The Court found that the stock dividend did not involve the realization of a taxable gain but that the corporation's accumulated profits were simply capitalized or retained as surplus. Id. at 211. In effect, the taxpayer in Eisner had not yet realized a gain severed from and independent of the corporations' assets. Id. at 211-12. In reaching that decision, the Court stated that income is the "gain derived from capital, from labor, or from both combined." Id. at 201.

Taxpayers read Merchant's Loan and Eisner together with certain other cases – Burnet v. Harmel, 287 U.S. 103 (1932); Bowers v. Kerbaugh-Empire Co., 271 U.S. 170 (1926) – as supporting their contention that the individual income tax can only be assessed against corporate gain. Taxpayers base their conclusion on selected case citations which, when taken together, purportedly limits the definition of "taxable income" to the definition originally established under the Corporation Excise Tax Act of 1909 and the Revenue Act of 1924. The conclusion that only a "corporation" can earn "corporate income" is not particularly startling. However, even setting aside questions concerning the soundness of taxpayers' legal analysis, taxpayers' review of corporate income tax cases is entirely irrelevant.

Taxpayers' legal argument stands for nothing more than that a legal argument can be advanced which will support any legal conclusion no matter how far-fetched. Taxpayers cite cases in which the Court was asked to determine what constituted *corporate income* under the corporate income and excise taxes in effect at the time the Court reached its conclusion. In each of the cases cited by taxpayers, the Court was asked to determine if certain income was subject to the federal corporate income tax law. Not one of the cases cited by taxpayers addresses the issue of whether the wages received by an individual are subject to federal income tax. It is sufficient to say that the cases simply do not get the taxpayers where they want to go.

The United States Supreme has clearly stated that the wages of individual citizens may be subjected to an adjusted gross income tax. In New York v. Graves, 300 U.S. 308 (1937), Justice Stone stated "That the receipt of income by a resident of the territory of a taxing sovereignty is a taxable event is universally recognized." Id. at 312.

Since that 1937 decision, the federal courts have consistently, repeatedly, and without exception, determined that individual wages are income. United States v. Connor, 898 F.2d 942. 943 (3rd Cir. 1990) ("Every court which has ever considered the issue has unequivocally rejected the

argument that wages are not income"); Wilcox v. Commissioner of Internal Revenue, 848 F.2d 1007, 1008 (9th Cir. 1988) ("First, wages are income."); Coleman v. Commissioner of Internal Revenue, 791 F.2d 68, 70 (7th Cir. 1986) ("Wages are income, and the tax on wages is constitutional."); United States v. Koliboski, 732 F.2d 1328, 1329 n. 1 (7th Cir. 1984) ("Let us now put [the question] to rest: WAGES ARE INCOME. Any reading of tax cases by would-be tax protesters now should preclude a claim of good-faith belief that wages – or salaries – are not taxable") (Emphasis in original); United States v. Romero, 640 F.2d 1014, 1016 (9th Cir. 1981) ("Compensation for labor or services, paid in the form of wages or salary, has been universally held by the courts of this republic to be income, subject to the income tax laws currently applicable. . . . [Taxpayer] seems to have been inspired by various tax protesting groups across the land who postulate weird and illogical theories of tax avoidance all to the detriment of the common weal [sic] and of themselves.").

In addressing the identical issue, the Indiana Tax Court has held that, "Common definition, an overwhelming body of case law by the United Sates Supreme Court and federal circuit courts, and this Court's opinion . . . all support the conclusion that wages are income for purposes of Indiana's adjusted gross income tax." Snyder v. Indiana Dept. of State Revenue, 723 N.E.2d 487, 491 (Ind. Tax Ct. 2000). *See also* Thomas v. Indiana Dept. of State Revenue, 675 N.E.2d 362 (Ind. Tax Ct. 1997); Richey v. Indiana Dept. of State Revenue, 634 N.E.2d 1375 (Ind. Tax Ct. 1994).

As set out in the Indiana Constitution, "The general assembly may levy and collect a tax upon income, from whatever source derived, at such rates, in such manner, and with such exemptions as may be prescribed by law." Ind. Const. art X, § 8. The Indiana General Assembly exercised its constitutional prerogative by imposing an adjusted gross income tax on individuals and corporations. IC 6-3-1-3.5 et seq. In doing so, the General Assembly defined an individual subject to the adjusted gross income tax as a "natural born person, whether married or unmarried, adult or minor." IC 6-3-1-9.

Taxpayers are of the opinion that with the right combination of "legal arguments," they can render themselves immune from federal and state tax liability. There is not one single federal or state court case which supports such a notion. Wishful thinking aside, given that taxpayers received gross income (I.R.C. § 61) during 1999 and 2000, are "individual[s]" under IC 6-3-1-9, were residents of Indiana for the years 1999 and 2000 (IC 6-3-1-12), and are "taxpayer[s]" as defined within (IC 6-3-1-15), the statutes imposing the Indiana individual income tax apply with full force to taxpayers' 1999 and 2000 income.

FINDING

Taxpayers' protest is denied.

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